Massachusetts Electric
A **National Grid** Company

December 17, 2004

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: D.T.E. 02-79/03-124/03-126

Dear Secretary Cottrell:

On behalf of Massachusetts Electric Company, Nantucket Electric Company (together "Mass. Electric" or "Company"), and New England Power Company ("NEP"), we are responding to the comments of the Division of Energy Resources, The Energy Consortium, and the Northeast Energy Efficiency Council, Inc. (together the "Restructuring Signatories"), the Massachusetts High Technology Council ("MHTC"), Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (together "Constellation"), and Dominion Retail, Inc. ("Dominion") (collectively, "Commenters") on the November 18, 2004 Offer of Settlement between Mass. Electric, NEP, and the Massachusetts Attorney General filed in the above-captioned dockets ("Settlement").

The Commenters' comments relate to the recovery of standard offer supply costs that will remain at the end of the standard offer period. These costs, estimated to total $66,359,359, are listed in Attachment 3 to the Settlement. They include generation information system ("GIS") costs, congestion costs, post-standard market design Independent System Operator – New England ("post-SMD ISO" costs), renewable portfolio standards ("RPS") costs, the estimated 2003 standard offer deferral not recovered by the end of 2004, and the estimated standard offer deferral at February 28, 2005. As described in Attachment 3 and the Company's response to Department Information Request DTE 1-1, these costs are either before the Department in Docket DTE 03-124 (costs incurred October 2002 through September 2003) or were incurred or estimated to be incurred subsequent to that time period through February 28, 2005, the end of standard offer. The Commenters do not contest Mass. Electric's right to recover these costs (Restructuring Signatories comments at 3; Constellation comments at 17; and MHTC at 1 (supporting the Restructuring Signatories' comments).[1] Rather, the Commenters only object to the timing and mechanism for recovery of these standard offer supply costs.

[1] Dominion does not specifically address this issue, but appears not to contest the validity of the costs themselves.

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The deferral, and resulting price path provide significant benefits to customers, and are key components of the Settlement.

Under the November 18, 2004 Settlement, Mass. Electric will defer standard offer supply costs until 2010, as provided by Section I.B.5(b) of the Company's restructuring settlement in D.P.U./D.T.E. 96-25 ("Restructuring Settlement"), with interest at Mass. Electric's customer deposit rate. The customer deposit rate is based on the interest rate for two year treasury bills, which is currently estimated at 1.65 percent. As we explained in our November 18, 2004 filing letter, this deferral at such an attractive interest rate provides significant economic value to customers, and the economic value that it produced led to the resolution of the other issues presented by the Settlement. Specifically, the deferral of supplier related costs at the customer deposit rate provides $18.2 million of value over a deferral at Mass. Electric's cost of capital, and the deferral of unrecovered Standard Offer costs adds another $33.1 million for a total of $51.3 million. This deferral not only provides economic value to customers, it mitigates the rate impact associated with moving from Standard Offer Service to Default Service at the end of the Standard Offer Service period in March of 2005. Under the Settlement, typical bills for an average residential customer increase only 2.2 percent and typical bills for average small commercial customers decrease slightly by 0.1 percent. The Settlement thus provides stable rates during transition from standard offer service to default service, and assures that Mass. Electric's customers experience a smooth transition to the shorter term retail price signal. Under the Settlement, all retail customers will pay the full price associated with default service after standard offer service ends.

The Commenters would eliminate the central economic benefit from the Settlement and as a result undermine the basis for the entire Settlement. As we explained in the November 18 Filing Letter (pp. 3-4 of the Filing):

> Although the Proposed Settlement ascribes different credits and values to specific cases and proceedings for purposes of implementing the Proposed Settlement's provisions and most effectively mitigating the rate effects that will occur at the end of the Standard Offer Service period, the Parties focused on the total value produced by the Proposed Settlement as the key factor when resolving the outstanding issued presented in the cases. Individual parties evaluated each case differently and were able resolve all the cases together because, as a whole, the Proposed Settlement provided sufficient value to resolve all outstanding issues. Thus, the Proposed Settlement should be evaluated as a complete package, and approved or rejected as a whole.

See also paragraph 9 of the Settlement at p. 30 of the Filing. Thus, the Department should evaluate the issues raised by the Commenters in the context of the entire Settlement. As we explain below, the entire Settlement is just and reasonable, and the specific issues that are the focus of the Commenters' concerns are consistent with prior agreements approved by the Department, the Department's prior orders, and the Department's policies.

The Commenters in fact recognize that the deferral specified in the November 18 Settlement is consistent with the express provisions of Mass. Electric's Restructuring Settlement. However, they attempt to read the requirements of the Restructuring Agreement out of the 1996 document. The Restructuring Settlement provides that: "Under-recoveries, if any, that remain after the standard offer period ends . . . shall be recovered from all retail delivery customers by a uniform surcharge not exceeding $0.004 per kilowatt-hour commencing on January 1, 2010." All agree that the deferral is consistent with this provision. However, the Commenters would eliminate this provision from the Restructuring Settlement. Specifically, Constellation recommends that the Department determine, pursuant to Section VII.D of the Restructuring Settlement, that the provision in the Restructuring Settlement requiring deferral of unrecovered standard offer costs until 2010 is no longer effective because of intervening regulatory actions. (Constellation comments at 16). The Restructuring Signatories, all of whom signed the Restructuring Settlement, appear to recommend this as well, stating that the competitive market for supply did not evolve as quickly and robustly as they thought it would when they entered into the Restructuring Settlement. (Restructuring Signatories at 2-3). MHTC, also a signatory to the Restructuring Settlement, echoes the comments of the Restructuring Signatories. (MHTC comments at 1-2). Dominion also argues that deferral would negatively impact the competitive market. (Dominion comments at 2-4)

As discussed below, there is nothing in the record of these dockets, or elsewhere for that matter, which supports the Commenters' contention that the Restructuring Settlement in general, or Section I.B.5(b) thereof in particular, is no longer effective. To the contrary, the Restructuring Settlement as approved by the Department July 14, 1997, and which the Department later determined "substantially complies or is consistent with the [Restructuring] Act," remains in effect and intervening events have not undermined that effectiveness. There is no compelling reason to deviate from its terms now. The Settlement is consistent with the Restructuring Settlement and the Department's rate setting goals, and provides significant retail customer benefit. Elimination of the deferral would undermine these benefits and the Settlement itself. Mass. Electric strongly recommends that the Department approve this Settlement, including the deferral, as it is in customers' interest.

Mass. Electric has incurred and recovered standard offer costs pursuant to the Restructuring Settlement

Under the Restructuring Settlement, Mass. Electric guaranteed its standard offer prices, subject to a fuel price index, and an adjustment factor to recover prior under recoveries. Restructuring Settlement Sections I.B.1.(d) and I.B.5. The signatories to the Restructuring Settlement acknowledged that Mass. Electric's revenues for standard offer might not be sufficient to recover its payments to suppliers by agreeing that Mass. Electric would recover any under-recoveries that remain at the end of the standard offer period from "all retail delivery customers by a uniform surcharge not exceeding $0.004

per kilowatt-hour commencing on January 1, 2010." Restructuring Settlement Section I.B.5.(b). The meaning of this provision could not be more clear.

For much of the standard offer period, the price of standard offer service has not allowed Mass. Electric to recover the costs it has incurred providing the service. As the Commenters note, various changes have occurred which have required that Mass. Electric incur additional costs in providing standard offer service that were unforeseen at the time the Restructuring Settlement was executed. These costs related to RPS, SMD, and congestion. Contrary to Constellation's assertion, quoting DTE 00-67 (Constellation comments at 4), Mass. Electric's standard offer rate has not always reflected "the full costs of the service, in order to promote competition." In fact, as described in response to Information Request DTE 1-7 in Docket DTE 03-124, the Company tried, in DTE 00-67, and two additional times, to revise its Standard Service Cost Adjustment Provision to enable it to recover more currently amounts it was incurring as a result of its obligation to provide the service. The first time was in Dockets DTE 99-60[2] and DTE 00-67. The second time was in Docket No. DTE 02-79,[3] and the third time was on February 28, 2003, which the Department never docketed.

Because Mass. Electric was not recovering the substantial costs it was incurring in the provision of standard offer service, Mass. Electric made its Exogenous Factor filing pursuant to Section I.C.1 of the rate plan settlement approved by the Department in Docket D.T.E. 99-47 ("Rate Plan Settlement"), docketed as DTE 03-124. Under the Rate Plan Settlement, the Company has the right to file for a distribution rate change[4] as a result of the following events: (1) tax and accounting changes which, individually, would affect Mass. Electric's costs by more than $1 million annually (§I.C.1.a); (2) legislative or regulatory changes that would impose new or modify existing obligations or duties on the Company which, individually, affect the Company's costs by more than $1 million annually (§I.C.1.b); and (3) the reclassification of costs to, or away from, transmission or generation from, or to, distribution (§I.C.1.d). The Rate Settlement provides for an annual filing of exogenous factors, to the extent that they may exceed the annual thresholds established under the Rate Settlement, by December 1 of each year, to become effective for usage on and after January 1 of the following calendar year. Exogenous factors are to be applied to all kWh billed by the Company through a uniform, fully reconciling surcharge or credit factor. Any request for an exogenous factor is also subject to review and approval by the Department. See §I.C.2 of Rate Settlement. The Division of Energy Resources and The Energy Consortium are both signatories to the Rate Plan Settlement. Nevertheless, neither they nor the other Commenters requested

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[2] The Company notes that all Commenters but Dominion and MHTC are on the service list of DTE 99-60, and none of the Commenters recommended Department approval of the Company's request or took any other action relative to it.

[3] The Company notes that Constellation is a limited participant in DTE 02-79, but did not recommend that the Department approve the Company's request or take any other action relative to it.

[4] Recovering exogenous factors through distribution rates has clear precedent. *See e.g.* Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company, and Commonwealth Gas Company, D.T.E. 99-19 at 25.

intervenor or limited participant status in DTE 03-124. At the public hearing in DTE 03-124, Roger Borghesani, on behalf of The Energy Consortium stated, "As an original settling party to the merger in 1999, I have just kind of a vested interest in making sure that the charges that they're putting forth are consistent with the settlement" and added that he is "in support of the filing as long as it's consistent with the settlement." January 28, 2004 transcript, pp. 4-5.

Despite the clear language in both the Rate Plan Settlement and the Restructuring Settlement that these costs be collected from the Company's delivery customers, most of the Commenters recommend that the Company recover the standard offer supply costs through supply charges or a surcharge on default service rates. (Constellation comments at 17, Restructuring Signatories comments at 3-4, DMHTC comments at 2). Although Dominion's comments indicate that Dominion believes these costs should not be deferred because they will distort the market for generation services (e.g. Dominion comments at 2), Dominion does not make an alternative proposal, but merely recommends that the Department deny the Settlement. (Dominion comments at 4). As noted above, the Division of Energy Resources and The Energy Consortium signed both settlements, and Northeast Energy Efficiency Council, Inc. and MHTC signed the Restructuring Settlement. Nevertheless, they, Constellation, and Dominion now urge the Department to determine that the provision in the Restructuring Settlement regarding collection of unrecovered standard offer costs commencing in 2010 ineffective. The Company strenuously disagrees with this recommendation, which flies in the face of the Company's adherence to the Restructuring Settlement since it was approved by the Department, to both its betterment and its detriment.

The Commenters point to Section VII.D of the Restructuring Settlement as support for their position. This section provides that:

> The Department approval of this Settlement shall endure so long as is necessary to fulfill the Settlement's objectives. In the event of future regulatory actions other than actions required by legislative actions taken prior to the Retail Access date, or legislative actions after the Retail Access Date, which may render any part of this Settlement ineffective, Mass. Electric and NEP shall nevertheless be held harmless and made whole through rates to Mass. Electric's customers.

Oddly, Constellation argues that default service did not exist in the Restructuring Settlement. (Constellation comments at 12) The Restructuring Signatories join Constellation in noting that the Restructuring Settlement creates basic service "[i]n recognition that customers may face an occasional hiatus between competitive suppliers." As the Restructuring Signatories note, during the time when the parties negotiated the Restructuring Settlement, there was general optimism about the development of the retail competitive market. The Company agrees that use of the words "occasional hiatus" does exemplify that optimism. Nevertheless, basic service and default service are clearly the same, the difference being their name only. Basic service is the commodity service to be supplied by Mass. Electric for customers not receiving standard offer or competitive

supply. The Department's approval of the Restructuring Settlement as consistent with the Electric Industry Restructuring Act of 1997 makes this clear. Calling basic service default service does not make the deferral provision ineffective.

Neither does slower than anticipated growth of the retail competitive market make the deferral provision ineffective. The Restructuring Settlement requires the deferral; it sets no conditions on the state of the competitive market for its applicability. The Restructuring Settlement is silent as to how many customers are to remain on standard offer to make the deferral provision ineffective. It merely states that if future actions render it ineffective, or the Department's approval is no longer needed to fulfill its objectives, the part that is no longer necessary shall be deemed ineffective. The Restructuring Settlement has been the backbone for the implementation of restructuring in Mass. Electric's service territory, and Mass. Electric has abided by it. That the Restructuring Signatories and MHTC do not now like one provision that they assented to as part of a comprehensive settlement is not enough to render it ineffective.[5] Indeed, it is unfortunate that the Commenters passed on the opportunity to formally participate in these dockets or comment on Mass. Electric's earlier attempts to revise its Standard Offer Cost Adjustment Provision to advocate for Mass. Electric to recover its supply costs as close in time as possible to when it incurs them.

In fact, the Commenters' suggestions in this case do not cure the basic issue that they raise. Under all proposals, the standard offer costs will be recovered from all customers at a time well after the costs were incurred. Mass. Electric is proposing to recover the power supply costs of default service as those costs are incurred during the period after standard offer service ends. Recovering the deferred standard offer supply costs in the twelve months after the end of standard offer service ends as the Commenters suggest still involves a charge for default service supply that is totally unrelated to the cost of that default service supply. Given that the costs are not related to current service, collection early does not send a correct price signal. Rather, it imposes an early surcharge on customers that will lead to rate effects and customer dissatisfaction with markets that are avoided under the Settlement. The Commenters' suggestion for early collection of the deferral does not produce a "better price signal," it produces only a "higher price." The Department should reject the suggestion, and base next year's default service prices on the current costs that are associated with the winning default service bids. It should reject the imposition of an unnecessary surcharge that will only produce customer dissatisfaction.

Constellation states that the Restructuring Settlement has been changed numerous times as conditions have changed and circumstances have warranted. (Constellation comments at 14) The changes that Constellation cites were all made in 1997 in response

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[5] MHTC's comments are particularly one-sided. MHTC acknowledges that a "significant number" of its members have been purchasing electricity from competitive suppliers since 1998. (MHTC comments at 1) Now that MHTC members have had seven years of benefits from the Restructuring Settlement, it recommends that the Department ignore that portion of the Restructuring Settlement that creates an obligation for its members, the recovery of deferred supply costs from delivery customers.

to input from the Department, the Massachusetts State Senate, and the Federal Energy Regulatory Commission, and the passage of the Electric Industry Restructuring Act of 1997. Since then, all parties have abided by its terms.

The Settlement provides significant value to customers and is consistent with Department principles

In addition to resolving a number of outstanding issues, the Settlement allows for a smooth transition for standard offer customers at the end of the standard offer period. Today's rates are proposed to remain in place through February 2005 and will smooth the total impact associated with customers moving from standard offer to default service.

Constellation argues that by deferring cost recovery of supply costs and then recovering them through distribution rates, the Settlement violates principles of equity and cost causation. (Constellation comments at 9).[6] As a preliminary matter, Mass. Electric notes that the parties to the Restructuring Settlement agreed to, and the Department approved, this method of cost recovery. This issue has already been addressed and determined: the Restructuring Settlement did not violate these principles or the Department would not have approved it. In addition, the Settlement provides rate stability and continuity for Mass. Electric's customers, consistent with another articulated Department goal. *See e.g.* Fitchburg Gas and Electric Light Company, D.T.E. 02-24/25 at 357.

Constellation also facetiously asks why, if deferral is a good thing, the Company does not defer all of its costs for greater customer value. (Constellation comments at 10.) The Settlement enables the Company to collect what it is entitled to, no more and no less. That it is able to recover its costs in a way that provides stability and value to customers is a positive aspect of the Settlement.

Constellation and Dominion argue that the deferral will undermine the competitive market. Dominion states that the Settlement will result in competitive suppliers competing against "artificially-depressed" rates. (Dominion comments at 3) On the contrary, the converse is true. As explained above, after the Standard Offer period ends on March 1, 2005, Mass. Electric will under the Settlement recover in retail rates the full costs of default service as provided by the winning bidder for that service. The various alternatives proposed, including a one year surcharge on default service prices for default service customers by Constellation and a one to two year surcharge on default service customers who converted from standard offer on March 1, 2005, would not

[6] There is nothing in the Restructuring Settlement that provides for the vehicle by which Mass. Electric would recover any remaining deferral balance. The Restructuring Settlement only states that it will recover any remaining deferral from all of its customers. This means that the charge will be a delivery charge, which is not limited to distribution charges. Mass. Electric has not contemplated where it would recover the deferral, but it has some flexibility on where it can do so. For example, it can implement a separate factor to appear on all customers bills, similar to Service Quality factors it has implemented in the past.

provide a better price signal. Rather it would artificially increase default service prices during that short time period. While this may create more of an opportunity for competitive suppliers, it will certainly create higher prices for consumers without the corresponding value that the Settlement offers. In addition, Mass. Electric questions what will happen at the end of this short period when the default service price no longer includes these extra costs.

As a practical matter, Mass. Electric cannot implement the alternative methods for collection of the supply costs proposed by Constellation, the Restructuring Signatories, and MHTC

Constellation, the Restructuring Signatories, and MHTC recommend that Mass. Electric recover its deferred standard offer supply costs through a one year surcharge on default service rates beginning May 1, 2005. It is likely that the Company will not have the final accounting for all costs to be deferred by April 1, 2005 (thirty days prior to an effective date of May 1, 2005) in order to make a factor filing at the Department. For example, ISO supplier reallocations are approximately five months behind and ISO makes adjustment to its charges for energy that are also several months behind. In addition, the Company is not required to show compliance with RPS requirements for the months of January and February 2005 until July 2006. Therefore, there will be costs subject to deferral relating to the service period in question.

The Restructuring Signatories believe that the best alternative would be for this surcharge to apply only to those default service customers who converted from standard offer on March 1, 2005. Once standard offer ends and Mass. Electric moves standard offer customers to default service, the Company's billing system will not be able to separately identify these customers for the purpose of applying a different set of default service rates designed to recover the deferred costs without the investment of a significant amount of resources.

Mass. Electric reserves the right to respond to additional comments that may be filed with the Department

Mass. Electric reserves the right to respond to additional comments that parties may file on the Settlement. Mass. Electric recognizes that it has requested Department action on the Settlement by December 30, 2004, and will provide any additional comments to the Department as quickly as possible.

We appreciate the opportunity to provide these comments. Thank you very much for your time and attention to this matter.

Very truly yours,

Thomas. G. Robinson
Amy G. Rabinowitz

cc: Service Lists